No. 22143

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PENNALUNA & COMPANY, INC.
BENJAMIN A. HARRISON, and
HARRY F. MAGNUSON,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR REVIEW OF
ORDER OF SECURITIES EXCHANGE COMMISSION

REPLY BRIEF OF PETITIONER MAGNUSON

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FILED
AUG 12 1968
WM. B. LUCK, CLERK

INDEX

	Page
TABLE OF AUTHORITIES.....	ii
INTRODUCTION.....	1
PART I	
(a) Substantial Evidence Does Not Support The Commission's Finding on Questions of Control.....	2
(b) Substantial Evidence Does Not Support The Commission's Finding of Allegedly Willful Violations of the Act.....	3
(c) The Sanctions Imposed Are So Disproportionate To the Violations Alleged and Found as to Constitute An Abuse of Discretion on The Part of The Respondent Commission.....	7
(d) Petitioners' Objections to Staff Conduct Both Timely and Meritorious.....	13
PART II	
(a) Staff's Adversary Role Herein Constitutes Denial of the Due Process.....	17
(b) The Use of Depositions Taken Without Notice to the Parties and Without the Opportunity of Confrontation or Cross Examination Violates Administrative Due Process.....	19
(c) In Quasi-Penal Proceedings, Government Must Meet A High Burden of Proof.....	20
CONCLUSION.....	21

TABLE OF AUTHORITIES

Cases: Page

Associated Security Corp. v. SEC, 293 F.2d 738..... 20

Berko v. SEC, 316 F.2d 137, 141..... 20

Copper Heating & Plumbing v. Campbell, 290 F.2d 368..... 11

Giles v. Maryland, 385 U.S. __, 17 L. Ed. 2d 737..... 14,15,17

Gonzales v. Freeman, 334 F.2d 570, 574..... 8

Green v. McElroy, 360 U.S. 474, 79 S. Ct. 1400, 3 L. Ed.2d 1377..... 18,20

Hemans v. U. S., 163 F.2d 228, 237, 238..... 10

Linden v. U. S., 254 F.2d 560, 568 (1958)..... 5

Sacher v. Association of the Bar of the City of New York 347 U.S. 388, 74 S. Ct. 569, 98 L. Ed. 790; see also, Re Isserman, 345 U.S. 286, 73 S. Ct. 676, 97 L. Ed. 1013; debarment set aside on reh., 348 U.S. 1, 75 S. Ct. 6, 99 L. Ed. 3..... 7

Simmons v. U. S., 348 U. S. 397, 75 S. Ct. 397..... 18

U. S. v. Cavallero, 36 U.S.C.M.A. 653, 654..... 9,11,12

U. S. v. Flag, 11 U.S.C.M.A. 636..... 15

U. S. v. Judd, 11 U.S.C.M.A. 164, 170..... 12

U. S. v. King, 12 U.S.C.M.A. 71, 74..... 12

U. S. v. Phillips, 217 F.2d 435, 438-41 (1955)..... 5

U. S. v. Shaefer, 299 F.2d 625, 630-31 (1962)..... 6

U. S. v. Wiley, 278 F.2d 500, 504..... 11

Smith v. U. S., 273 F.2d 462..... 10,11

Weems v. U. S., 217 U.S. 349..... 7

Williamson v. U. S., 207 U.S. 425, 52 L. Ed. 278, 292-93 (1908)..... 5

Others:

Administrative Procedures Act, 60 Stat. 243 (1946). 5 U.S.C. §§ 1001-1011..... 18

Comp. Gen. Dec. B-139720 (Jan. 6, 1960)..... 8

Manual for Courts Martial (1951)..... 9

Securities and Exchange Commission Release No. 8063, p. 3 6

UNITED STATES COURT OF APPEALS
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REPLY BRIEF FOR PETITIONER MAGNUSON

INTRODUCTION

The General Counsel's brief for Respondent contends that substantial evidence supports the Respondent's finding that Petitioner Magnuson was a controlling person of Silver Buckle Mining Company and West Coast Engineering, Inc. throughout the period of alleged distribution; that substantial evidence supports the Respondent's finding of allegedly willful violations of the antifraud and antimanipulation provisions of the Securities laws; that the sanctions imposed were well within the discretionary authority of the Respondent Commission; and, that Petitioners' objections to the staff's conduct are untimely and without merit.

Part I of this Reply shall address itself to each such contention. In addition, Part II shall reply to the conclusion of the Respondent's General Counsel that the evidentiary and procedural standards were adequate in law.

PART I.

(a) Substantial Evidence Does Not Support The Commission's Finding on Questions of Control

The Statement of Facts in the instant proceeding reads as though it were an effort to redraft Genesis in the terms of the Cour D'Alene Mining District. A single incident of Petitioner Magnuson's accounting firm rendering service to Silver Buckle -- of 18 years past -- becomes the opening warp of the blanket of intrigue. Slight business and social relationships in this district of low population density becomes the framework of the story. Petitioner Magnuson's efforts to salvage the financial investment of the stockholders once he, in fact, became involved, becomes the proof. But, the Respondent has wholly ignor the problems of relevancy and reasonableness in its findings.

We shall not burden this Court with further restatement of the facts. We simply refer to the Brief of Petitioners.

Dr. Scott's unrefuted testimony establishes that the group in control of Silver Buckle from the time of Petitioner Magnuson's purchase until the June, 1963 merger included Gay, the Browns, the West Coast directors and himself [Tr. 2050-2051]. At any extent, even conceding, arguendo, [1/] that in fact a control relationship existed, substantial evidence does not support the contention that any ensuing breaches of the Act were willful.

(b) Substantial Evidence Does Not Support The Commission's Finding of Allegedly Willful Violations of the Act

The Respondent Commission contends that Petitioner Magnuson was a controlling person, that his sales of stock were intentional and with knowledge of his control relationship, and, that they were, therefore, willful. These findings ignore the substantial facts of record.

The facts are that when Petitioner Magnuson purchased his Silver Buckle stock from New Park and East Utah, New Park was in possession of a legal opinion, the validity of which does not appear to be contested, holding that New Park was not a

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1/ We, of course, do not so concede.

"control person" vis-a-vis Silver Buckle [Tr. 196, 2183]. This opinion was conveyed to Petitioner Magnuson at the time of his purchase of the Silver Buckle stock. Similarly, it was warranted to Petitioner Magnuson at the time of purchase, that the New Park and East Utah Silver Buckle stock were not subject to any S. E. C. restrictions [Tr. 1214, 2592]. Clegg, counsel for New Park and East Utah, and one who knew fully of Petitioner Magnuson's other interests and involvements [Tr. 197, 1185, 1197, 1215], told Petitioner Magnuson that the stock could be traded [Tr. 1215].

Finally, subsequent to the purchase of the Silver Buckle stock, Petitioner Magnuson received a legal opinion from still another source, Piatt Hull. Hull is a Wallace, Idaho attorney whose firm served as Petitioner Magnuson's personal counsel [Tr. 983], and had drafted the New Park-East Utah agreements [Tr. 1215] Petitioner's unrefuted testimony is that he told Hull everything that was involved [Tr. 983]. That opinion advised Petitioner Magnuson that he was not a person in direct or indirect control of Silver Buckle. Petitioner Magnuson himself has testified that he did not feel he could influence the management of Silver Buckle, and that he was not the controlling person at this time [Tr. 1218].

In Williamson v. U. S., the Supreme Court held that the following jury charge adequately stated the principal governing reliance on advice of counsel:

> "If a man honestly and in good faith seeks advice of a lawyer as to what he may lawfully do in the matter ... and fully and honestly lays all facts before his counsel and in good faith and honestly follows such advice, relying upon it and believing it to be correct, and only intends that his acts shall be lawful, he could not be convicted of a crime which involves willful and unlawful intent."[2/]

Similarly, under the Internal Revenue Code, the courts recognize that the word "willful" as respects offenses of willfully and knowingly attempting to defeat and evade income taxes means more than intentionally or voluntarily, and includes an evil motive, or bad purpose, so that an actual bonafide misconception of the law would justify a verdict for the defendant.[3/] It is, of course, true that legal advice does not constitute an unpregnable wall of defense,[4/] and that legal advice is a fact to

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2/ Williamson v. U. S., 207 U.S. 425, 52 L. Ed. 278, 292-93 (1908)

3/ U. S. v. Phillips, 217 F.2d 435, 438-41 (1955).

4/ Linden v. U. S., 254 F.2d 560, 568 (1958).

be considered with other facts in determining the question of the defendant's good faith.[5/] However, there is no justification in the facts of this record for the Respondent Commission's contention that the counsel failed to give consideration to certain facts [Tr. 4613].[6/] In any event, the Respondent Commission failed to apply the proper standard in evaluating the effect, if any, of the reliance on advice of counsel in the present proceeding.

We submit that where, as here, Petitioner Magnuson's good faith reliance on advice of his counsel is uncontested, he cannot be found to have willfully violated the Securities Act by the sale of unregistered stock. The relief sought is the quasi-punative action of revocation and debarment. We do not suggest that reliance on advice of counsel would defeat an action where the relief sought is truly remedial, i.e., the injunctive prohibition in the future of acts deemed in violation, or the recovery of damages incurred in the purchase of such stock; those problems simply are not involved.

5/ U. S. v. Shaefer, 299 F.2d 625, 630-31 (1962).

6/ Securities and Exchange Commission Release No. 8063, p. 3.

(c) The Sanctions Imposed Are So Disproportionate To The Violations Alleged and Found as to Constitute An Abuse of Discretion on The Part of The Respondent Commission

We urgently plead the Court to focus upon the severity of the sanctions here imposed. Wholly aside from any prior representation by the Respondent's staff as to what sanctions were deemed appropriate,[7] the sanctions here adopted are neither reasonable nor just in the factual circumstances involved. We do not question that the Respondent is empowered by the Congress to impose such a penalty. We submit, however, that its imposition in the factual circumstances here is a clear abuse of discretion.

For example, permanent debarment for an attorney in comparable circumstances -- first offense, previously unblemished record, a pillar of the community with a history of active support of regulatory activity -- would be untenable.[8] The permanent barring of an individual from the pursuit of his profession, on his first offense, is, indeed, an abuse of discretion constituting cruel and unusual punishment proscribed by the Eighth Amendment.[9]

7/ This matter will be discussed in Section (d) hereof.

8/ Sacher v. Association of the Bar of the City of New York, 347 U.S. 388, 74 S. Ct. 569, 98 L. Ed. 790; see also, Re Isserman, 345 U.S. 286, 73 S. Ct. 676, 97 L. Ed. 1013; debarment set aside on reh., 348 U.S. 1, 75 S. Ct. 6, 99 L. Ed. 3.

9/ Weems v. U. S., 217 U.S. 349.

As noted by the Court in Gonzales v. Freeman:

> "The consequences of administrative ... debarment, will vary, depending upon multiple factors: the size and prominence of a contractor; the ratio of ... [debarred] ... business to ... [non-debarred] business;.... The impact of debarment ... may be a sudden contraction of bank credit, adverse impact on market price of shares, ... and critical uneasiness of creditors generally, to say nothing of 'loss of face' in the business community. These consequences are in addition to the loss of specific profits from the business denied as a result of debarment. We need not resort to a colorful term such as 'stigma' to characterize the consequences of such governmental actions, for labels may blur the issues. But we strain no concept of judicial notice to acknowledge these basic facts of economic life."10/

Debarment has been characterized as "so severe that its imposition may destroy a going business, ... the power of debarment is tantamount to one of life or death over a business."11/

Conceding, arguendo, that such power is vested in the Respondent Commission, we turn to the question: Is it appropriat in the present case? In the Federal system, the Court of

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10/ Gonzales v. Freeman, 334 F.2d 570, 574.

11/ Comp. Gen., Dec. B-139720 (Jan. 6, 1960). Unpublished letter to Secretary of Labor, quoting the Attorney General's Committee on Administrative Procedure, Division on Public Contracts.

Military Appeals has established an unmatched expertise in the field of evaluating the appropriateness of a particular sanction to a particular factual pattern. In setting up the Uniform Code of Military Justice, the Congress and the President called on the best minds in the fields of criminology, penalogy, sociology, and the law. Their combined efforts find expression in Paragraph 76a of the Manual for Courts of Martial. With respect to what constitutes the appropriate sanction, it is stated:

> "Normally, the maximum punishment will be reserved for an offense which is aggravated by its circumstances and the conditions surrounding its occurrence -- or a case in which there is evidence of a previous conviction involving an offense at least as serious as the one for which the accused is on trial."12/

The Court of Military Appeals, in implementing this Act, has held that "a sentence which is not fair and just should not be approved."13/

The military courts are not alone in recognizing that the imposition of sanctions can be the subject of abuse. It has

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12/ Manual for Courts Martial, § 76a (1951). The Manual is, of course, the regulations promulgated by the President for implementation of the Uniform Code of Military Justice, 10 U.S.C. 801-939.

13/ U. S. v. Cavallero, 36 U.S.C.M.A. 653, 654.

been held that long-term imprisonment could be so disproportionate to the offense as to fall within the inhibition (Eighth Amendment prohibition against cruel and unusual punishment).[14/] And, where the record showed that the defendant was a first offender and did not indicate the case was an aggravated one, it was held that the imposition of the maximum sentence was "greater than should have been imposed."[15/]

We are, of course, left to conjecture as to what prompted the imposition of the maximum sanction in the present proceeding. Whereas, staff initially suggested settlement for a brief suspension, as the parties, and their counsel sought to assert their rights to defend themselves, the price of settlement increased. Having rejected settlement and sought a ruling of the Respondent Commission, they are now faced with permanent debarment from the pursuit of their professions. This strongly suggests that the Respondent seeks here to convey a message to those subject to its powers that it looks with disfavor on those who seek to defend themselves against the Respondent staff's

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14/ Hemans v. U. S., 163 F.2d 228, 237, 238.

15/ Smith v. U. S., 273 F.2d 462.

accusations -- those who defend rather than submit -- will be punished.

This practice has been rightly severely critical by the courts. In U. S. v. Wiley, after noting that (as here) the defense was neither frivolous or in bad faith, the Third Circuit stated:

> "Our part in the administration of federal justice requires that we reject the theory that a person may be punished because in good faith he defends himself when charged with a crime, even though his effort proves unsuccessful. It is evident that the punishment imposed by the district court on Wiley was in part for the fact that he had availed himself of his right to a trial, and only in part for the crime for which he was indicted."16/

We earnestly submit that judicial precedent establishes that the maximum sanction is appropriate only for the aggravated case.17/ We recognize that the imposition of sanctions such as debarment are an important tool in the administration of the Securities Act.18/ But, in imposing a sanction in each particular

16/ U. S. v. Wiley, 278 F.2d 500, 504.

17/ U. S. v. Smith, supra.; U. S. v. Cavallero, supra.

18/ Cf. Copper Heating & Plumbing v. Campbell, 290 F.2d 368.

case, the agency shifts from the quasi-administrative capacity to its quasi-judicial capacity. The courts have held that in imposing sanctions, administrative policy, per se, has no valid place, [19/] and that sanctions should not be imposed by a fixed formula, [20/] but, rather, the quantum should be fixed as it is specially suited to the circumstances of the parties in each case. [21/]

Assuming, arguendo, the Respondent properly found willful violations of the Securities Act, we earnestly submit that the sanctions inflicted demand revision; and that in no event is a suspension in excess of 60 days appropriate on the factual circumstances. We recognize that it is not customarily the province of this Court to re-assess sanctions imposed or sentences assessed. We, therefore, earnestly suggest that if the Court finds adequate support for the findings of violations herein, the matter be remanded to the Respondent Commission for re-evaluation of the penalties assessed in conformance with such guidance as the Court deems appropriate.

19/ U. S. v. Cavallero, supra.

20/ U. S. v. King, 12 U.S.C.M.A. 71, 74.

21/ U. S. v. Judd, 11 U.S.C.M.A. 164, 170, Judge Fergusan's concurring opinion.

(d) Petitioners' Objections to Staff Conduct Both Timely and Meritorious

By action of the Secretary dated September 12, 1967, the Respondent Commission rejected for filing a Petition and Motion for Further Rehearing, Reconsideration and Review in this proceeding, bearing date of September 1, 1967, which was served on the Respondent Commission on September 5, 1967. That Petition and Motion, which are appended herein as Exhibit A, brought to the Respondent Commission's attention, apparently for the first time, certain allegations concerning the conduct of the staff of the Respondent in the present proceeding, and also contended that the penalties assessed herein constituted an abuse of discretion in general conformance with the arguments raised in Section (c) hereof.

The Petition and Motion in substance contended that the staff of Respondent materially misled the parties and their counsel as to the gravity with which the matter under investigatio was viewed by their superiors and by the Respondent Commission. It pointed out that the parties were grossly misled as to the punative measures deemed appropriate to the offenses which the staff considered to have been established. This attitude by the staff of the Respondent trapped and misled the parties and their

counsel to accept an unduly abbreviated, Stipulated Statement of Fact, which they believed that would be all that would be placed before the Respondent Commission in the course of the procedures adopted. The Petition further contended that the staff of the Respondent, by assumption of an extreme adversary role, had reduced the proceeding to one similar to that castigated by the Supreme Court in the Giles case.[22/]

We earnestly suggest that the allegations raised by the Petition and Motion are of such gravity and of such a nature as to demand, in the interest of justice, consideration by the Respondent Commission. As is evident by the recent Petition for Amendment of Record herein, filed by your Petitioners, material evidence, in fact, exists to support Petitioners' contention in the above Petition and Motion that they had been affirmatively misled as to the real intentions and demeanor of the staff.

It is earnestly suggested that where contentions of this nature are raised, the interest of justice and administrative process demand their evaluation by the Commission. Accordingly,

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22/ Giles v. Maryland, 385 U.S. ___, 17 L. Ed.2d 737.

the record herein should be remanded to the Commission for further hearings on this issue. In the alternative, we urge this Court to consider the propriety of the staff's conduct of this case. In an administrative proceeding, such as the instant case, it "is not a game in which the [staff's] function is to outwit and entrap its quarry. The [staff's] pursuit is justice, not a victim."[23/] Thus, staff and the Commission must insure fair consideration to all evidence in the case, and when their participation establishes a propensity to convict, regareless of matters presented, justice demands reversal of such actions.[24/] We submit that failure to comport to these standards in the instant proceedings has resulted in a proceeding which is making mockery of the Petitioners' rights to administrative due process. This shall be discussed in Part II below.

PART II.

THE PROCEEDINGS HEREIN DO NOT COMPORT WITH ADMINISTRATIVE DUE PROCESS OF LAW

We submit that, viewed in toto, the proceedings herein have failed to afford the Petitioners their minimum entitlement

23/ Giles v. Maryland, supra. See, particularly, concurring opinion of Mr. Justice Fortes, 17 L. Ed.2d 759.

24/ Cf. U. S. v. Flag, 11 U.S.C.M.A. 636, and cases cited therein

to administrative due process. The Petitioners have been the victims of a staff so steeped in its adversary role as to initially misrepresent the purpose of the private investigation and ultimately to entice the Petitioners' cooperation by the misrepresentation of the sanctions to be recommended to the Commission for the violations allegedly found. Depositions of witnesses were taken and used in the proceeding -- without notice to the parties, without an opportunity of participation of counsel, and, of course, without affording the parties the right of cross-examination. Indeed, the rules of the Respondent under which these proceedings were conducted make it a matter of the grace of the Respondent Commission to determine if a party whose deposition is taken will be afforded the privilege of obtaining a copy of his transcribed record. Finally, we submit that the so-called preponderance of the evidence standard applied as the burden of proof in the instant proceeding is inappropriate in light of the sanctions imposed and the nature of the proceedings.

(a) Staff's Adversary Role Herein Constitutes Denial of the Due Process

We respectfully submit that an administrative proceeding "is not a game in which [staff's] function is to outwit and entrap its quarry. The pursuit is justice, not a victim." 25/ And, yet, in the origins of this proceeding, McCoy of the staff of the Respondent invited Petitioner Magnuson to come to Seattle to discuss the purchase of Silver Buckle stock. There, he was confronted with a full and complete private investigation, which was recorded and transcribed, wholly without prior notice that any formal proceeding was involved [R. 969]. To this auspicious beginning, a fitting conclusion was added -- the parties were enticed to enter into a Stipulated Statement of Fact in lieu of a public hearing on the misrepresentation of the severity of the sanctions sought by the staff.

We need not remind this Court of the strong economic pressures on a public broker to avoid public investigation if at all possible. But, here, the ensuing procedure did not

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25/ Giles v. Maryland, supra.

provide the parties, rightfully, access to the investigative file.[26] The deposition of Petitioner Magnuson was conducted without knowledge of any prior investigation of the staff. It is well settled that the administrative agencies, under the Administrative Procedures Act,[27] must at least provide parties, whose conduct is the subject of their investigation, a fair resume of the record.[28] Thus, the courts do not view this provision as a matter of grace within the Commission's discretion, but rather as an essential element.[29] Mr. Justice Clark in the Simmons case stated bluntly that Congress, in providing for a hearing, "did not intend for it to be conducted on the level of a game of blindman's bluff."[30]

26/ Although, in fairness to staff, in the course of drafting the Stipulation, certain files and statements were made available for review -- although copies or resumes thereof were not given out. Indeed, the Commission rules do not allow copying of private investigation orders.

27/ 60 Stat. 243 (1946). 5 U.S.C. §§ 1001-1011.

28/ Green v. McElroy, 360 U.S. 474, 79 S. Ct. 1400, 3 L. Ed.2d 1377.

29/ Simmons v. U. S., 348 U.S. 397, 75 S. Ct. 397.

30/ Simmons v. U. S., supra. at p. 405.

In this instant case, this is particularly critical for, as is established by our Petition for Amendment of the Record, there were indeed additional matters considered by the staff and the Commission which were not made known to the parties. And, the severity of the sanctions makes it self-evident that these matters adversely affected the parties' rights herein. We pray that the Court conclude that the Commission's order based on a violation of due process be reversed.

(b) The Use of Depositions Taken Without Notice to the Parties and Without the Opportunity of Confrontation or Cross Examination Violates Administrative Due Process

The record in the present proceeding includes depositions of various witnesses received by the staff in the course of its private investigation, as well as the deposition of one Anthony Vaghi, taken on February 2, 1966. These depositions were taken without notice to the parties and failed to afford the parties the opportunity of cross examination and confrontation. The use of such material in administrative proceedings is a deprivation of the rights of the parties to

administrative due process.[31] When the use of such material is coupled with the inappropriate burden of proof standard, the mockery of administrative due process is complete.

(c) In Quasi-Penal Proceedings, Government Must Meet A High Burden of Proof

The right to hold specific, private employment and to follow a chosen profession free from unreasonable governmental interference comes within the "liberty" and "property" concepts of the Fifth Amendment.[32] The Respondent Commission's contention that its statute, being remedial warrants a preponderance of evidence standard, is without judicial support.[33] The Berko case relied on by the staff is inappropriate because the Court there failed to distinguish between the evidentiary standard appropriate to issue injunctive relief against a continuing or future act, and the quasi-penal punative action here involved.[34]

31/ Green v. McElroy, supra. at pages 1390 - 1392.

32/ Green v. McElroy, supra. at pages 1388 - 1389.

33/ Berko v. SEC, 316 F.2d 137, 141.

34/ In Berko, supra., the court, as does the General Counsel here, was seeking to rely on the Associated Security Corp. case (Associated Security Corp. v. SEC, 293 F.2d 738), a case involving revocation of a registration statement.

CONCLUSION

We submit that clear and convincing evidence must upport a revokation and debarment action. That support imply does not exist in the present record.

Respectfully submitted,

/s/

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CERTIFICATE OF SERVICE

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